

Employer's Instructions for the Employee's Arizona Withholding Percentage Election

Arizona Form A-4

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Arizona Revised Statutes (ARS) § 43-401 requires an employer to make the Form A-4 available to employees at all times and to inform employees of the Arizona withholding election options authorized by the statute. **Arizona withholding is a percentage of the amount of federal income tax withheld.**

New Employees

New employees must complete this form within the first five days of employment. If the employee does not complete this form, the employer must withhold the minimum withholding percentage based on the employee's annual compensation. If the employee's annual compensation is less than \$15,000, the minimum withholding percentage is 10 percent. If the employee's annual compensation is \$15,000 or more, the minimum withholding percentage is 19 percent.

Current Employees

Current employees must complete this form to elect a different Arizona withholding percentage. If the employee wants to increase or decrease the amount of Arizona withholding, the employee must complete this form to change the Arizona withholding percentage.

Electing a Withholding Percentage of Zero

An employee may elect an Arizona withholding percentage of zero, if the employee meets BOTH of the qualifying conditions for the election. An employee making this election certifies that: (1) the employee had no Arizona income tax liability for the prior taxable year, AND (2) the employee expects to have no Arizona income tax liability for the current taxable year. If an employee makes this election, the employer will not withhold Arizona income tax from the employee's compensation for payroll periods beginning after the date of the employee's election.

Effective for the first payroll period in 2005, an employee must complete the Form A-4 to elect a higher Arizona withholding percentage OR to elect the zero withholding percentage for payroll periods in 2005, if the employee meets the qualifying conditions for the taxable year 2005. If the

employee does not timely complete the Form A-4, the employer must withhold the minimum withholding percentage based on the employee's annual compensation. The employer must make the Form A-4 available to employees at the beginning of 2005.

Voluntary Withholding Election by a Nonresident Employee Exempt Under ARS § 43-403(A)(5)

A qualifying employee may use this form to voluntarily elect to have a portion of the employee's compensation withheld under the provisions of ARS § 43-403(D)(1) for application toward the employee's Arizona income tax liability. The employee completes this form to elect an Arizona withholding percentage.

QUALIFYING CRITERIA FOR THE ARS § 43-403(A)(5) EXEMPTION. The exemption under the provisions of ARS § 43-403(A)(5) applies to wages paid to nonresident individuals who are:

1. Employed by a company having property, payroll, and sales in Arizona or by a related entity having more than 50 percent direct or indirect common ownership; **and**
2. Physically present in Arizona for less than 60 days in a calendar year for the purpose of performing a service that will benefit the employer.

Activities not included in determining the number of days of service are:

- a. Being in transit.
- b. Engaging in personal activities.
- c. Participating in training or professional development activities or attending meetings that are not directly connected to the Arizona operations of the employer.

Note: This exemption does not apply to a nonresident employee who is in this state solely for athletic or entertainment purposes.

A "RELATED ENTITY HAVING MORE THAN 50 PERCENT DIRECT OR INDIRECT COMMON OWNERSHIP" mentioned above includes any situation in which the related entities are more than 50 percent owned by the same interests. The following examples illustrate three different situations in which the nonresident employee is performing services in Arizona for such an entity for less than 60 days during a calendar year. In these examples, the employer has met the qualifying criteria for the ARS § 43-403(A)(5) exemption and, therefore, does not have to withhold Arizona income taxes from compensation paid to the employee for services performed in Arizona.

Example 1:

Corporation A is the U.S. domestic parent of Corporation B, a wholly owned foreign subsidiary corporation. Corporation A has property, payroll and sales in Arizona. Corporation B operates in China and does not have property, payroll and sales in Arizona. Individual R, an Arizona nonresident, is an

employee of Corporation B. Individual R performs services for Corporation B in Arizona for 45 days during the calendar year 2004.

Example 2:

Corporation F, based in California, is the common parent of Corporation W. Corporation F does not have property, payroll and sales in Arizona. Corporation W does have property, payroll and sales in Arizona. Individual L, an Arizona nonresident, is an employee of Corporation F. Individual L performs services for Corporation F in Arizona for 55 days during the calendar year 2004.

Example 3:

Individual D owns 60 percent of Corporation K and 51 percent of Corporation S. Individual N owns 40 percent of Corporation K and 49 percent of Corporation S. Corporation S has property, payroll and sales in Arizona. Corporation K, based in California, does not have property, payroll and sales in Arizona. Individual T, an Arizona nonresident, is an employee of Corporation K. Individual T performs services for Corporation K in Arizona for 35 days during the calendar year 2004.

How to Determine the Minimum Withholding Percentage

An employer determines the applicable rate of withholding for each employee *who has not elected a zero percent withholding rate for the taxable year* as follows:

1. If an employee whose annual compensation is less than \$15,000 elects the minimum withholding rate, that rate shall apply until one of the following situations occurs:
 - a. Until the employee has 12 full months of work history with the employer, the employer shall determine the employee's annualized compensation at the end of each month. *The employer may use any method of annualization which accurately reflects the employee's annual compensation.*

Example		
At the end of the month, an employer must annualize the compensation of an employee with 3 1/2 months of work history with the employer. The employee's compensation is annualized as follows:		
First full month of compensation		\$ 1,500
Second full month of compensation	+	1,500
Third full month of compensation	+	1,500
Fourth partial month of compensation	+	925
Total compensation (3 1/2 months)	=	\$ 5,425
Divide by number of payroll periods in the 3 1/2 months	÷	7
Average payroll period compensation	=	\$ 775
Multiply by number of payroll periods in a calendar year	×	26
Annualized compensation	=	\$ 20,150

If the employer determines that the employee's annualized compensation is \$15,000 or more, the employer shall adjust the employee's rate of

withholding beginning the next full pay period following the determination. The employer shall adjust the rate to the minimum rate prescribed by ARS § 43-401, unless the employee elects a higher prescribed rate of withholding for the employee's annual compensation. The minimum rate of withholding shall apply until the employee has been employed for 12 full months, unless the employee elects a higher prescribed rate of withholding for the employee's annual compensation. After 12 full months of employment, the employer shall determine the rate under (b) below;

- b. If the employee has 12 full months of work history with the employer, the employer shall determine the employee's total compensation for the 12-month period. If the records for that period show that the employee earned \$15,000 or more, the employer shall adjust the rate of withholding beginning the next full pay period following the determination. The employer shall adjust the rate to the minimum rate prescribed by ARS § 43-401, unless the employee elects a higher prescribed rate of withholding for the employee's annual compensation. The minimum rate of withholding shall apply through the end of the calendar year, unless the employee elects a higher prescribed rate of withholding for the employee's annual compensation. At the end of that calendar year and at the end of each succeeding calendar year, the employer shall redetermine the employee's total annual compensation. If the employee's annual compensation for the preceding year changes the employee's rate of withholding, the rate change shall begin the next full pay period following the determination unless the employee makes a zero percent withholding election for the taxable year; or
 - c. If the employee receives a salary increase that makes the employee's annualized compensation \$15,000 or more, the employer shall adjust the employee's rate of withholding to the minimum rate prescribed by ARS § 43-401, beginning the next full pay period following the receipt of the increase by the employee.
2. An employee who has elected a withholding rate higher than the minimum prescribed withholding rate may later elect to reduce the rate to a lower prescribed rate for the employee's annual compensation.